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TREASURY FOR INTERNATIONAL AFFAIRS - CPLANTIER

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SUBJECT: THIRD TIME'S A CHARM ON SOCIAL SECURITY REFORM?

REF: ANKARA 1629 AND PREVIOUS

Sensitive but unclassified. Not for internet distribution.

[11.](#) (SBU) Summary: After two earlier aborted attempts, the Turkish Government seems to be on the verge of passing social security reform legislation. Under an expedited procedure to prevent opposition party delaying tactics, a bill merging the three social security institutions passed on April 13. Once the second bill -- changing pension formulas and instituting universal health insurance -- has passed, the IMF is likely to send a mission for its third review. In spite of the Government opting to raise the retirement age only to 65 rather than raising the age all the way to 68, the IFIs are likely to accept the package which is badly needed to gradually reduce the social security system's massive deficits. End Summary.

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Third time's a Charm?  
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[12.](#) (SBU) Having pulled back from a severe confrontation with the main opposition Republican People's Party (CHP) and the labor unions both in June and November 2005, the Government now seems to be on the verge of pushing through the social security reforms. There are two separate pieces of legislation: the first, which passed April 13, merges the three social security institutions. The other would institute universal health insurance and would change the parameters by which pensions are calculated. Both are needed to fully implement IFI-agreed reforms and to gradually reduce the systems from bleeding red ink. In 2005 the three institutions' combined deficit was 23.3 billion lira, or about 4.78% of GDP. Arguing for passage of the bill, Labor Minister Basesioglu noted that if the current system were left in place the deficit is projected to grow to about 10% of GDP.

[13.](#) (SBU) With the bills reported out of the Plan and Budget Commission and now before the full parliament, the opposition once again seemed poised to engineer the Turkish equivalent of a filibuster: asking the maximum number of questions for each article under the proposed law. The CHP had successfully used this tactic in June and November to bog down proceedings. Rather than making any substantive argument, the CHP and smaller opposition party ANAP continue to focus on the Government's perceived subservience to the IMF.

[14.](#) (SBU) At a World Bank-Turkish Treasury conference April 14, Basesioglu signaled the Government had given up trying to work with its critics, fearing the "reform structure" of the legislation would be gutted. The Government apparently decided the risk of the opposition winning points with nationalistic public opinion was worth taking to get to an IMF review and to finally pass the reform for its own sake. On April 12 GOT resorted to an expedited procedure whereby both bills would be considered in chunks of articles, so as to reduce the CHP's opportunities to delay. On April 13, with the CHP deputies having walked out, parliament passed the bill merging the three institutions. The crucial bill revising the pension formulas and instituting universal health insurance are now expected to pass in a week to ten days.

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The Importance of Being Solvent  
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[15.](#) (SBU) The reforms constitute a watershed for Turkey, ranking among the most important economic reforms under the AKP government. Without the social security systems' combined deficit, Turkey's public sector would now be in surplus, despite its still substantial debt burden and high interest payments. The deficits arose from inefficiencies and weak collection of social security premia, but mainly from Turkey's uniquely-generous retirement rules: in a 1991 fit of populism, Prime Minister Suleyman Demirel reduced retirement ages to 38 for women and 42 for men. Despite a 1999 reform which mandated a phase-in to older retirement

ages (58 for women, 60 for men), retired people in their 40's still abound, and in many cases continue to work while drawing on their social security pension.

16. (SBU) Several factors played into the timing of the GOT making a concerted push: With the IMF program riding on the reform, and much discussion among economists about a possible sell-off in emerging markets this year, the Government may have realized they could not risk further delay, which would bring them into election season. Moreover, the longer the GOT waited, the harder the reform will be, since Turkey's still-young population is expected to age considerably over the coming decades. Fertility rates have declined markedly over the past thirty years and life expectancy is rising. As a result, the share of the elderly in the general population is expected to increase from 5.7% now to 14% by 2035, eventually rising to 20%. With its gradual phase-in of higher retirement ages and a less generous pension formula, the reform will only reduce the deficit by 1% of GDP in ten years, but over the long run is projected to reduce the overall social security deficit to 1% of GDP (from 4.78% in 2005).

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Erdogan Appeals to Public Opinion  
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17. (SBU) Prime Minister Erdogan personally appealed to AKP parliamentarians in a speech April 10. Without going into too much detail, he noted the fiscal necessity of the pension reform, while at the same time, dangling the carrot of expanded health insurance benefits, including free access to medical care for children under 18. The World Bank economist confirmed this had been agreed to by the IFI's: the Bank's health experts believe the provision of free medical care to children is justified by the costs to the economy of the alternative -- poor or nonexistent medical care for children. However, the economist explained that it is not free medical care for all children: the measure is designed such that the state would pay the insurance premium only for low-income people -- above a certain income threshold people have to pay their own premia.

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IFI's Likely to Swallow GOT Dilutions  
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18. (SBU) According to the World Bank economist, so far the IFI's have detected two alterations of the package from what had been previously been agreed. The retirement age will not go beyond 65, whereas the plan was to eventually have the retirement age reach 68. The other, less significant change is a more generous plan for pensions to widows. Although the World Bank economist said the Bank's experts would do their thorough analysis of the legislation only after it passed parliament, he gave credit to the Government for finally re-energizing the reform effort. Unless there are major deviations from what was agreed earlier, the Bank and Fund seem unlikely to insist on amending legislation given the political risk the Government has taken in passing the reform. IMF officials have long planned to send a third review mission once the legislation is passed, and are still expected to do so, probably at the end of April or beginning of May.

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